



Goldman Sachs Research

## We can work it out (can we?) A market perspective on the insurance industry

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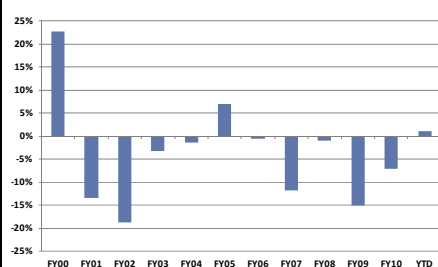
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## To date, the insurance sector has been a poor performer

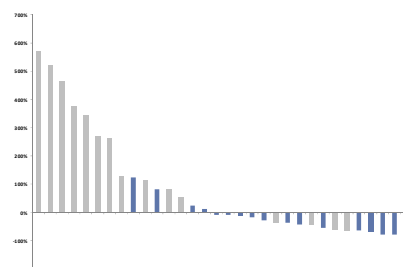


### The insurance sector has underperformed the market in 9 of the last 11 years



Source: Datastream

### Total shareholder returns over a 12-year period

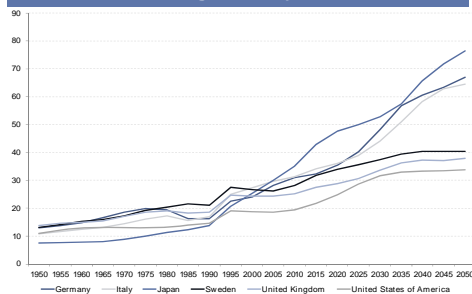


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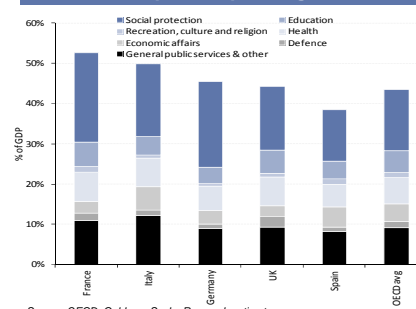
## Demographics are actually favourable People are living longer, governments are spending less

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### Dependency ratios are forecast to grow significantly



### Social protection is largest component of public spending



### The large European pensions schemes are unfunded or "pay as you go"

Country	Median Age of Withdrawal From Labour Market		Duration of 'Complete Retirement'		Method of indexation	Funding	Basic Pension as a % of Economy Wide Average Earnings	Net Replacement Rate
	Men	Women	Men	Women				
France	59.4	59.7	15.5	23.9	Price	PAYG	0	84%
Germany	60.3	60.1	18.8	23.2	Average net earnings	PAYG	13%	72%
Italy	58.8	57.9	20.7	26.2	Price	PAYG	-	90%
Netherlands	60.4	59.8	18.2	23.2	Net minimum wage	PAYG	35%	43%
UK	62.6	60.4	16.8	22.3	Price	PAYG	20%	50%

Source: OECD, 'Public Pensions'; Aitd, Berry, Low (University of Cambridge).

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## Valuation: confusion abounds

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- Problems stem from liability valuations – most methods rely on mean reversion
- Some management incentives are driven by an economic framework, some by accounting framework and some by a hybrid. There is no clear intersection btw the various metrics
- How do we know we have NOT entered an environment with a step change in investment conditions

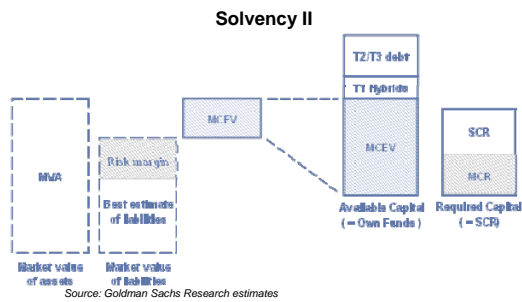
IFRS	Traditional EV / FCF	MCEV	Statutory
<ul style="list-style-type: none"> <li>Assumptions used to calculate liabilities can be locked-in at inception</li> <li>Results in static liability charge overstating the earnings in the current environment</li> </ul>	<ul style="list-style-type: none"> <li>Also does not reflect the fair value of the liability</li> <li>Cash flows depend on real world assumptions which are deterministic</li> </ul>	<ul style="list-style-type: none"> <li>MCEV declines when interest rates fall</li> <li>The only economic based measure available but is very conservative</li> </ul>	<ul style="list-style-type: none"> <li>Calculated on a different basis depending on the geographical region</li> </ul>

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## Regulation: the potential to re-shape an industry

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### Some of the Solvency II issues that remain unresolved:

- US equivalence
- Calibration of liquidity premium
- Grandfathering of existing reserves and debt instruments
- Internal model approval
- Ultimate risk free rate
- Matching premiums

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## Risk: Asset and interest rate concerns have impacted the sector

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### 10yr government bond yields (%)



### Equity market performance (S&P)



- Long duration bond yields on a downward trend in the past 30 years
- This implies that the fair value of liabilities have increased over time
- Strong equity market performance in 80s and 90s helped offset the increase in liabilities
- Lower equity market returns in the past decade, more difficult for assets to outpace the liabilities

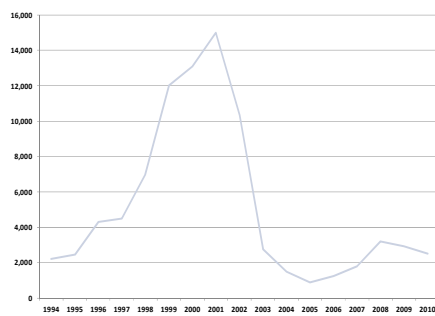
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## Is the demand for (and recognition of) actuarial contribution diminishing?

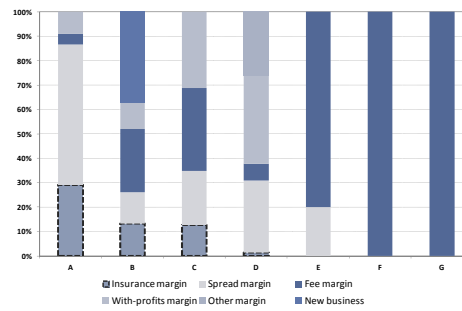


### With-profit sales in the UK have peaked



Source: ABI

### 2010 UK operating profits had limited contribution from pure insurance products



Source: Company data



Disclosure Appendix  
November 18, 2011

## Disclosure Appendix



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